PUBLIC SERVICE COMMISSION OF WISCONSIN
REPORT TO THE LEGISLATURE ON OPERATIONS
OF ALLIANT ENERGY CORPORATION FOR 2000-2001

Background

Relevant Statutes

In November 1985, the Wisconsin Legislature enacted 1985 Wisconsin Act 79 (Act 79). Act 79 approved the formation of holding companies by non-telecommunication public utilities and created Wis. Stat. § 196.795.

Wis. Stat. § 196.795(7)(ar) provides that three years after the formation of a holding company under this section, the Public Service Commission of Wisconsin (Commission) shall report its findings under Wis. Stat. § 196.795(7)(a) to the legislature. Thereafter, the Commission shall submit to the legislature a report on the impact of the holding company, including the benefits and adverse effects on every public utility affiliate in the holding company system and on the investors and consumers of such public utility affiliates, at least once every two years. The report shall include any recommendations for legislation relating to the regulation of any part of a holding company system.

Alliant v. Bie[1]

In October 2000, Alliant and WP&L filed a complaint in the United States District Court, Western District, challenging the constitutionality of five provisions of Wisconsin law under the commerce and equal protection clauses. The four statutory provisions applicable to Alliant involve sections of the Wisconsin Holding Company Act, Wis. Stat. § 196.795 and the application of a section of the Act to Wis. Stat. § 201.01(2) making the public utility holding company a public service corporation rendering the issuance of securities by the holding company subject to Commission approval. The statutory provision applicable to WP&L is Wis. Stat. § 196.53, which precludes a utility from transferring to a foreign corporation any license, permit, or franchise to own, operate, manage or control any plant or equipment for the production or furnishing of heat light or power.

The parties presently have Motions for Summary Judgment before the Court.

Alliant Holding Company System

On March 31, 1988, WPL Holdings, Inc. (WPLH) was formed and became the parent corporation of Wisconsin Power and Light Company (WP&L). On April 21, 1998, Alliant

[1] ALLIANT ENERGY CORPORATION AND WISCONSIN POWER AND LIGHT COMPANY, Plaintiffs, v. AVE M. BIE, JOSEPH P. METTNER AND JOHN H. FARROW, in Their Official Capacities as Commissioners of the Public Service Commission of Wisconsin., Defendants.

Energy Corporation (AEC or Alliant)[2] was formed through a series of interrelated transactions with WPLH, Interstate Power Company (IPC), IES Industries Inc. (IES), and their affiliates. The Commission had authorized the reorganization, subject to conditions, on November 5, 1997, in docket 6680-UM-100.

The following report is in accordance with Wis. Stat. § 196.795(7)(ar). The report discusses the impact of AEC on WP&L and WP&L's investors and customers, as well as the nature of each nonutility affiliate. A recommendation for legislation relating to the regulation of holding company systems is also discussed.

The report includes analysis and review of financial data from 1996 through 2001, and audit findings and recommendations concerning certain cost allocations for the 2001 period. The audit report in Appendix A focused on 2001 and following up some prior period recommendations.

General corporate information is provided in Appendices B, C, and D. Appendix B is an organizational chart for Alliant as of February 2002. Appendix C is a list prepared by Alliant of all the entities in the holding company system as of December 31, 2001. The list indicates how Alliant considers each entity for compliance with Wis. Stat. § 196.795(7)(a). Appendix D is a list of Total Assets and Employees, and Assets and Employees located in Wisconsin, as of December 31, 2001.

Appendix E contains a report prepared by the Securities and Exchange Commission (SEC) based on audit work done by a team of SEC staff and auditors from the Public Service Commission of Wisconsin (PSCW), and the Illinois Commerce Commission. The transactions reviewed by the SEC were from 1998 to 1999. Appendix F is a copy of Alliant's initial response to the SEC audit report and subsequent correspondence between Alliant and the SEC. Appendix G contains Alliant's response to this report.

Impact on Public Utilities

Section 1(7) of 1985 Wisconsin Act 79 provides that the public interest and the interest of investors and consumers can be protected if:

> (a) Transactions between a public utility in a public utility holding company system and the holding company or its nonutility affiliates are subject to public service commission approval and regulation to assure that reasonable prices are charged and costs properly allocated.
>
> (b) The nonutility activities of the public utility holding company system do not substantially lessen competition, do not tend to create a monopoly or restrain trade and do not constitute an unfair business practice.

[2] During the merger process, the reorganized company was referred to as Interstate Energy Corporation. On May 19, 1999, the company's stockholders voted to change the corporation name to Alliant Energy Corporation.

> (c) The public utility activities of a non-telecommunications public utility in a public utility holding company system remain subject to public service commission jurisdiction and regulation.
>
> (d) The activities of the public utility holding company system do not cause any materially detrimental effect on the public utility's rates for or reliability of utility service to the public, cost of capital or ability to raise capital.
>
> (e) The public service commission has access to the books and records of the public utility holding company system to the extent relevant for the commission to regulate any public utility in the system.
>
> (f) The provision of reliable and reasonably priced public utility service remains the predominant business of a public utility holding company system.

Wis. Stat. § 196.795(5)(g) further provides that:

> No holding company system may be operated in any way which materially impairs the credit, ability to acquire capital on reasonable terms or ability to provide safe, reasonable, reliable and adequate utility service of any public utility affiliate in the holding company system.

Wis. Stat. § 196.795(5)(b), (j), (r), and (s), explicitly require the Commission's continued jurisdiction over public interest items (a), (c), and (e), above. Consequently, the following discussion, which summarizes the impact AEC has had on its public utility affiliates and on the investors and consumers of such public utility affiliates, includes the size of nonutility business, financial impact, and the impact on utility rates and reliability of service.

Size of nonutility business

In its November 4, 1997, order in docket 6680-UM-100, which authorized the AEC merger, the Commission found it in the public interest to limit the investment in the holding company and nonutility affiliates to 25 percent of the Wisconsin and non-Wisconsin utility assets of AEC for purposes of Wis. Stat. § 196.795(6m)(b). It consequently conditioned the merger on the investment in the holding company and nonutility affiliates being limited to 25 percent of the Wisconsin and non-Wisconsin utility assets of AEC[3].

1999 Wisconsin Act 9 (Act 9) created Wis. Stat. § 196.795(6m)(e) in October 1999. Wis. Stat. § 196.795(6m)(e) provides a public utility holding company partial relief from limits on nonutility assets it may own if the electric utilities in the holding company system transfer their electric transmission facilities to a separate transmission company under Wis. Stat. § 196.485(5)(b).

On November 5, 1999, WP&L made an unconditional, irrevocable and binding commitment to transfer its transmission assets to the transmission company to be formed under Wis. Stat. § 196.485(5)(a). At that time Alliant had become a member of the Midwest ISO. Effective on January 1, 2001, WP&L and South Beloit Water, Gas and Electric transferred their electric

[3] Primarily pages 49 and 58 of the November 4, 1997, order in docket 6680-UM-100.

transmission system assets to the American Transmission Company, LLC in exchange for equity interests in this new company. During 2001, ATC issued debt and distributed cash of $75 million to WP&L as a partial return of their original equity contribution. AEC therefore met the criteria for the partial relief provided under Wis. Stat. § 196.795(6m)(e) from the limits on nonutility assets pursuant to Wis. Stat. § 196.485(5)(b), since November 5, 1999.

As of December 31, 2000, total ineligible[4] nonutility affiliate assets were 12.69 percent of total utility assets. On that date, the investment limit for nonutility investments, which equals 25 percent of total combined utility assets, amounted to $1.096 billion while actual ineligible nonutility assets totaled $557 million. This information is shown in more detail in Table 1.

Included in AEC's calculations for December 31, 2001 was $47.5 million of software owned by Alliant Energy Services and allocated to utility assets. This allocation is under question by Commission staff. Consequently, for December 31, 2001, a range was calculated using as the outer limits of the range the assumption that the $47.5 million is either totally utility, or totally nonutility. Consequently, as of December 31, 2001, total ineligible nonutility affiliate assets were between 9.94 percent and 11.12 percent of total utility assets. On that date, the investment limit for nonutility investments, which equals 25 percent of total combined utility assets, ranged from $1.099 billion to $1.111 billion. Actual ineligible nonutility assets ranged from $441 million to $489 million. This information is shown in more detail in Table 1.

Table 1
Alliant Energy Corporation
Utility and Nonutility Assets

	1996-2001 ($1,000)						
	2001 (1)(2)	2001 (1)(3)	2000 (1)	1999 (1)	1998	1997 (4)	1996 (4)
A. Utility assets	4,442,385	4,394,924	4,384,814	4,184,410	4,123,224	1,664,604	1,677,814
B. Nonutility affiliates	441,450	488,911	556,515	434,154	910,239	192,500	216,771
C. Holding company and inter-company transaction adjustment						4,703	5,946
D. Consolidated	4,883,835	4,883,835	4,941,329	4,618,564	5,033,463	1,861,807	1,900,531
E. Investment percent (Lines B + C / Line A)	9.94%	11.12%	12.69%	10.38%	22.08%	11.85%	13.27%
F. 25% of total combined utility assets	1,110,596	1,098,731	1,096,204	1,046,103	1,030,806	416,151	419,454

(1) Excludes eligible assets under Wis. Stat. § 196.795(6m).
(2) Includes $47.5 million as utility assets
(3) Includes $47.5 million as ineligible nonutility assets
(4) 1996 and 1997 reflect WPLH information

[4] Assets of nonutility affiliates which are neither an "Eligible asset" nor a "Wholesale merchant plant" as defined in Wis. Stat. § 196.795(6m)(a)2 and 6, respectively.

Financial

Wis. Stat. § 196.795(5)(g) provides that no holding company system may be operated in any way which materially impairs the credit or ability to acquire capital on reasonable terms of any public utility affiliate in the holding company system.

Since the appropriate operating parameters that the Commission may establish can be expected to change over time as the public interest requires, the following historical information is necessary to evaluate whether WP&L is meeting the criteria that the Commission found necessary to ensure that the utility is able to provide reliable, low cost service into the future.

1. Securities case order in docket 6680-SB-101 (January 30, 1986)

In this pre-holding company order relating to the issuance of securities, the Commission states: "It is fundamental to sound utility regulation that the capital structure of the utility must be adequate to support appropriate system maintenance and improvement without financial strain. In this context, and that of increased actual risk and the perception of increased risk by the financial community, the Commission finds that public interest will be served by applicant's achieving a utility capital structure containing no less than 50 percent equity for the present and near future."

The Commission also found that before WP&L funds non-utility ventures the Commission must first make sure that the utility maintains a healthy capital structure. In order to ensure the continued financial health of the utility, the public interest required that WP&L not fund non-utility ventures until the utility reached and maintained a 50 percent common equity ratio. An investment restriction was imposed that prohibited WP&L from using utility funds for non-utility investments until the company reached and maintained a 50 percent equity level. This restriction was later revised in docket 9403-YO-100.

2. Holding company formation order in docket 9403-YO-100 (April 30, 1987)

In this order the Commission found that the fundamental requirement for meeting the obligation to serve at reasonable cost is the continuing financial health of the utility. The Commission found that the following three elements of utility finance help to ensure that utilities are able to provide reliable, low cost service into the future:

1. a reasonable and balanced capital structure;
2. a dividend policy based on the utility's needs;
3. a commitment to fund capital construction needed to provide reliable and safe utility service.[5]

[5] Primarily pages 5 – 13 of the April 30, 1987, order in docket 9403-YO-100.

The Commission also reaffirmed its earlier findings[6] that the appropriate common equity ratio for WP&L was at least 50 percent. The Commission further found it necessary for WP&L to maintain its investment in utility operations in order to remain a strong ongoing utility. In order to ensure that utility equity was not used to finance non-utility investment before the utility reached 50 percent equity, the Commission ordered that any dividends paid by WP&L to its parent must be passed through immediately to the stockholders of WPLH. Thus, in general, all dividends paid from WP&L to WPLH were to be passed through to the shareholders of WPLH. This restriction would end when WP&L's equity ratio reached 50 percent.

3. Rate case order in docket 6680-UR-103 (October 13, 1988)

In this rate case docket, the Commission conducted an investigation of the appropriate capital structure for WP&L and determined that the appropriate range at that time was 45 to 50 percent equity. The projected average equity ratio for the test year ending July 31, 1989, was 49.52 percent. The Commission withdrew the dividend pass through requirement[7]. However, the Commission restricted WP&L from paying any greater than normal dividends in cases where such payment would result in the utility common equity ratio falling below the average level forecasted in the test year (49.52 percent).

4. Rate case order in docket 6680-UR-104 (November 9, 1989)

In this rate case for test year ending July 31, 1990, WP&L and Commission staff agreed that the utility common equity ratio should be increasing towards the 55 percent level to maintain interest coverage and financial health. Similarly, the Commission also determined that the percent of common equity in the utility capital should be increasing from the average test year level of 49.50 percent.[8]

5. Rate case order in docket 6680-UR-107 (December 22, 1992)

The order in this rate case does not discuss the appropriate capital structure levels. The Commission, however, determined that a reasonable utility ratemaking capital structure for the test year ending July 31, 1993, was 49.53 percent and restricted WP&L from paying any greater than normal dividends in cases where such payment would result in the utility common equity ratio falling below the average level forecasted in the test year (49.53 percent).

6. Rate Case order in docket 6680-UR-108 (September 30, 1993)

For the test year ending July 31, 1994, the Commission determined that a reasonable utility ratemaking capital structure was 50.31 percent and restricted WP&L from paying any greater than normal dividends in cases where such payment would result in the utility common equity

---

[6] Primarily pages 4 – 6, and 9 of the January 30, 1986, order in docket 6680-SB-101.

[7] Primarily pages 28 –31, 65, and 69-70 of the October 13, 1988, order.

[8] Primarily pages 16-18 of the November 9, 1989, order.

ratio falling below the average level forecasted in the test year (50.31 percent). The common equity ratio included a forecasted equity infusion by WPLH.

7. Rate case order in docket 6680-UR-109 (December 8, 1994)

For the test year ending December 31, 1995, the Commission determined that a reasonable utility ratemaking capital structure was 51.93 percent and restricted WP&L from paying any greater than normal dividends in cases where such payment would result in the utility common equity ratio falling below the average level forecasted in the test year (51.93 percent).

8. Rate case order in docket 6680-UR-110 (April 29, 1997)

For the test year ending December 31, 1997, the Commission determined that a reasonable utility ratemaking capital structure was 52.00 percent and restricted WP&L from paying any greater than normal dividends in cases where such payment would result in the utility common equity ratio falling below the average level forecasted in the test year (52.00 percent).[9]

9. Alliant formation order in docket 6680-UM-100 (November 4, 1997)

In the merger order, the Commission did not reiterate its discussion in docket 9403-YO-100 regarding the three elements of utility finance that help to ensure that utilities are able to provide reliable, low cost service into the future. However, the Commission directed that certain requirements from that order be carried over and specifically applied to Alliant.[10] These requirements include: Order Point 29, requiring WP&L to maintain a balanced capital structure within a reasonable range to be established by the Commission; Order Point 30 requiring the directors of WP&L to set dividend policy based solely on the capital needs and financial health of the utility, without regard to the need for capital on the part of the holding company, other utility affiliates, or other nonutility affiliates in the holding company system; and Order Point 31 requiring WP&L to submit ten-year financial strategic plans.

10. Current restrictions and findings

As of this report, AEC is not restricted from utilizing the funds received from WP&L as dividend payments to invest in non-utility investments. In addition, the Commission has not formally changed the 45 to 50 percent equity range it found appropriate for WP&L. However, as the historical information shows, the Commission has been moving the company equity level beyond the 1988 determined range. Furthermore, Table 2 shows that WP&L had moved its test year equity towards a 55 percent level by test year 1996. WP&L is restricted from paying any greater than normal dividends in cases where such payment would result in the utility common equity ratio falling below 52.00 percent. For dividend restriction purposes, normal dividends have typically been interpreted as the amount reasonably forecasted to be paid in the test year and the equity ratio as a 13-month average. WP&L is able to increase the dividend payment at

---

[9] Primarily pages 33 – 34, 83 and 90 of the April 29, 1997, order.

[10] Primarily pages 35, 56, and 57 of the November 4, 1997, order in docket 6680-UM-100.

the end of the test year if earnings are higher than expected and payment of the increased dividend will not result in an average test year common equity ratio below the forecasted level.

Table 2
Dividend Restriction Statistics

	1996-2001					
	2001	2000	1999	1998	1997	1996
Common equity ratio – 13-month average regulatory equity(1)	45.31%	48.85%	48.18%	51.13%	52.50%	54.77%
Dividend Restriction Equity Level (2)	52.00%	52.00%	52.00%	52.00%	52.00%	51.93%
Restricted Dividend Amount ($1,000)(2)	58,344	58,344	58,344	58,344	58,344	58,127
Dividends Paid ($1,000)	60,449	0	58,353	58,341	58,342	66,087

Source:
(1) Calculated from WP&L Financial Operating Reports. Does not include accounts receivables sales.
(2) From Docket 6680-UR-109 for 1996 and Docket 6680-UR-110 for 1997-2001

In 1996 and 1997, WP&L was not restricted to the normal dividends because its average equity level had been maintained above the restriction level. However, as shown in Table 2, WP&L's average equity level for 1998 through 2001 was below the 52.00 percent established in docket 6680-UR-110. Consequently, WP&L was restricted from paying more than the $58,344,000 forecasted in docket 6680-UR-110. WP&L's dividend payments for 1998 totaled $58,341,000 and WP&L did not pay any dividends in 2000. However, for 2001, WP&L's dividend exceeded the allowed dividend by $2,105,000.[11]

Dividend payment policy, however, is only one area of managing a reasonable and balanced equity structure. The common equity component of capital structure can be managed in two ways; either through dividend policy (i.e. the payment or retention of earnings) or by stock transactions (i.e. stock issuance or buy-backs). A growing company needs capital. Even in a good earnings year, a company may need to add equity beyond that obtained by retained earnings to meet its growth and balance its capital structure. Because a wholly owned subsidiary does not issue additional common stock in the financial markets, it relies upon its parent for capital contributions to fund the additional equity requirements. This means AEC, or WPLH prior to the merger, would have to make any additional investment in WP&L through an equity contribution.

Table 2 shows that WP&L's December 31, 2001, regulatory equity ratio was 45.31 percent. One reason for the decrease was the removal of the American Transmission Company investment from the regulatory capital structure in 2001. However, even if the asset had not been removed, WP&L's regulatory equity ratio would be 50.68 percent, still be below 52 percent. Furthermore, a review of the running 13-month average equity ratio shows that WP&L's equity ratio has been below 52 percent since April 1998. Since its last rate case, WP&L has allowed its equity position (relative to total capital) to erode substantially. Table 4 also shows an increase in financial leverage since 1996.

[11] See section on audit recommendations, Appendix A, page 7.

As will be discussed further under the Financial Statistics Section, ratings agencies are looking for more equity to compensate for the increased business risks expected when the electric utility industry becomes deregulated and competitive. WP&L's equity has been declining. WP&L must rely on AEC to make sufficient equity investment to maintain a balanced capital structure. However, AEC has not maintained its equity investment in WP&L. WP&L's dividend policy is not based on the utility's need. It is not retaining sufficient equity to maintain a balanced capital structure. WP&L has financed its growth through external debt and off-balance sheet obligations, not through both debt and equity, thereby weakening WP&L's capital structure.

11. Credit Ratings

Table 3 contains the credit ratings history for some of WP&L's stock or bond issues. Included are ratings for long-term secured securities, long-term unsecured securities, along with WP&L general corporate ratings from both Standard & Poor's Corporation (S&P) and Moody's Investors Services (Moody's).

Table 3

Wisconsin Power & Light Company
Corporate and Debt Ratings

	1996-2001					
	2001	2000	1999	1998	1997	1996
Corporate Ratings						
Standard & Poor's	A	AA-	AA-	AA-	AA	
Moody's Investors Services	Aa3	Aa3	Aa3	Aa3	Aa3	Aa3
Long-term Secured Debt						
Standard & Poor's	A+	AA	AA	AA	AA	AA
Moody's Investors Services	Aa2	Aa2	Aa2	Aa2	Aa2	Aa2
Long-term Unsecured Debt						
Standard & Poor's	A-	A+	A+	A+	AA-	N/A
Moody's Investors Services	Aa3	Aa3	Aa3	Aa3	Aa3	N/A

On March 3, 1998, S&P lowered the corporate credit rating of WP&L from AA to AA-. S&P lowered the senior unsecured debt rating from AA- to A+ and the preferred stock rating from AA- to A+. The ratings for the mortgage backed securities, the senior secured debt, remained unchanged at AA. In its announcement of the downgrading, S&P noted that the action was being taken "in anticipation of the upcoming merger that will create Interstate Energy Corp." Bond and preferred stock investors have seen the quality of the securities they purchased decline.

On March 26, 1998, Moody's confirmed WP&L ratings at Aa2 for secured debt, Aa3 for unsecured debt, and aa3 for preferred stock.[12] Moody's, however, notes in its confirmation that its ratings are based in part on the fact that the "Public Service Commission of Wisconsin has proscribed WP&L from paying any dividends that would reduce equity below approximately

[12] The rating criteria are independently set by the rating agencies and should not be viewed as identical. In addition, within each rating level there are ranges of expectations. In light of one agency downgrading a company, it would be an appropriate assumption for an investor that the company has slipped to a lower level within the other agency's rating range.

52 percent of total capital." As described earlier, the Commission's current dividend restrictions are not as restrictive as those described by Moody's confirmation. In addition, Moody's joint rating review (of WP&L, IES Utilities, and IPC) commented that debtholders have additional protections because of "the Wisconsin Holding Company Act, which will limit investments in unregulated business to 25% of the combined net utility assets of the three merged utilities."

On January 26, 2000, S&P revised its outlook for Alliant Energy and its subsidiaries, including WP&L, to negative from stable. In its release, S&P notes "The ratings reflect the strong business and financial profiles of the utility subsidiaries. . . However, Alliant's consolidated credit quality will be challenged by the company's focus on growing higher risk nonregulated businesses."

On October 17, 2001, S&P lowered Alliant Energy's corporate credit ratings from A+ to A-, commercial paper ratings from A-1 to A-2, and senior secured debt from A to BBB+. In addition, S&P lowered the corporate credit rating of WP&L from AA- to A. S&P lowered the senior secured debt ratings from AA to A+, the senior unsecured debt rating from A+ to A-, and the preferred stock rating from A to BBB+. This represents a downgrading of two notches. In its announcement of the downgrading, S&P noted that "Alliant's consolidated credit quality is challenged by the company's focus on growing the nonregulated businesses." Bond and preferred stock investors have again seen the quality of the securities they purchased decline.

Conversations with representatives of both S&P and Moody's reveal that, in general, the difference between S&P's and Moody's ratings reflect whether the rating agency believes that the utility is insulated from the other operations of the holding company.

S&P believes that the managers will manage the entire holding company together. It also believes cash can flow easily between affiliates and that it is difficult to make a case that a utility can be insulated from other affiliates. After developing a corporate rating, it evaluates the utility to see if it warrants a higher or lower rating than the corporate. Consequently, WP&L will be affected by credit down-grading of Alliant Energy.

Moody's rating process begins with an analysis of the utility. It looks at safeguards to insulate it. Such safeguards noted in Moody's analysis include the Wisconsin asset cap, which limits a holding company's investments in unregulated business to 25 percent of the combined net utility assets[13], and WP&L's dividend restriction which proscribes paying any dividends that would reduce equity below approximately 52 percent of total capital.[14]

S&P's downgrade of WP&L's senior secured debt in 2001 from AA to A+ represents an increase in cost of future issues of such debt of 17 basis points (according to SolomonSmithBarney for April 18, 2002, for investment grade 30-year bonds). For a bond issuance of $100 million, the additional interest expense would be $170,000 annually. If applied to all of WP&L's long-term debt of $536 million (see Table 4), the annual impact would be $911,200. In addition, each

[13] As discussed under the section size of nonutility business, partial relief from this restriction was provided in Act 9.

[14] As shown in Table 2 and 4, WP&L's dividend policy has not been able to proscribe WP&L from dropping below 52 percent.

downgrading results in a reduction of the security's value. Consequently, the holders of the downgraded securities experienced an impairment of their investment at the time of the downgrading.

For AEC, the common equity ratio on a booked basis is only 37.6 percent at the end of 2001 (see Table 4), and slightly less than 33 percent when off-balance sheet financing is considered. For WP&L, the common equity ratio on a booked basis is 50.6 percent, but drops to 37.2 percent when off-balance sheet financing is considered. WP&L's off-balance sheet obligations more than doubled during 2001, from $241 million to $498 million. The increase is related to the operating lease for the new Riverside Power Plant.

The managements of AEC and WP&L appear to be making financial decisions that could be to the detriment of the debtholders, preferred stockholders, and ratepayers. Security holders have seen their investments impaired while ratepayers will be affected by the higher interest rates WP&L will pay to acquire debt financings. Furthermore, WP&L does not issue its own equity securities, since it is entirely owned by AEC. WP&L relies on AEC to infuse WP&L with equity. Given AEC's continuing investment in nonutility affiliates and its low common equity as a percentage of total capital (even before considering off-balance sheet obligations), it appears that AEC may be either unwilling or unable to infuse WP&L with additional equity and to raise its own common equity percentage to a level that would restore WP&L's bond ratings to the level WP&L was at prior to its merger with the two Iowa utilities.

12. Financial Statistics

The year-end capitalization for WP&L and WPLH or AEC is listed in Table 4. For each entity, two capitalizations are shown. The first is the booked capitalization. This contains the companies' securities that are recorded on the balance sheet. However, not all indebtedness is recorded on the balance sheet. In light of recent concerns regarding the amount of such off-balance-sheet indebtedness, the second capitalization incorporates adjustments for WP&L's, WPLH's and AEC's off-balance-sheet obligations. The off-balance-sheet obligations consist of 100 percent of the present value (10 percent discount factor) of operating leases, 60 percent of the present value (10 percent discount factor) of purchased power agreements, and 100 percent of the sales of accounts receivables[15].

A review of Table 4 helps to put S&P's ratings actions in perspective. S&P has been requiring more equity and less debt for each level of its credit ratings. The most recent decrease in S&P's guidelines for debt ratios occurred in 1999. As seen in Table 4, WP&L's and AEC's proportion of debt has increased since 1996, not decreased as would be necessary to maintain its credit rating. Operating at this current level of leverage could reduce WP&L's financial flexibility for future projects or otherwise jeopardize its current financial ratings. With only one stockholder,

[15] The percentage of the off-balance sheet obligation factored into the capital structure varies based on an assessment of the obligations debt equivalency.

WP&L is dependent on AEC for equity infusions. However, AEC's capitalization is also highly leveraged and the company is pursuing increased holding company investments.[16]

Table 4

Year-end Capitalization

	1996-2001					
	2001	2000	1999	1998	1997	1996
WP&L						
Capitalization (in $1,000)						
Common Equity (1)	701,930	662,560	599,097	559,930	585,739	576,158
Preferred Stock (1)	59,963	59,963	59,963	59,963	59,963	59,963
Short-term Debt (1)	90,816	29,244	125,749	76,799	81,000	69,500
Long-term Debt (1) (2)	535,547	579,444	477,840	472,975	421,874	371,874
Off-Balance-Sheet Obligations (3) (OBSO)	498,080	241,249	219,270	222,082	251,250	187,808
Common equity ratio - Booked basis	50.56%	49.77%	47.45%	47.87%	51.00%	53.47%
Total Debt to Capital– Booked basis	45.12%	45.72%	47.80%	47.00%	43.78%	40.96%
Common equity ratio – With OBSO	37.21%	42.14%	40.43%	40.23%	41.84%	45.54%
Total Debt to Capital – With OBSO	59.61%	54.05%	55.53%	55.46%	53.87%	49.73%
AEC/WPLH (4)						
Capitalization (in $1,000)						
Common Equity (5)	1,918,341	2,037,472	2,155,565	1,606,295	607,583	607,355
Preferred Stock (5)	116,352	116,352	116,352	116,352	59,963	59,963
Short-term Debt (5)	152,722	444,735	424,719	116,284	123,095	102,779
Capital Lease (5)	37,646	46,115	39,362	25,733	0	0
Long-term Debt (5)	2,877,280	2,399,709	1,604,642	1,670,339	527,483	488,405
Off-Balance-Sheet Obligations (3)	713,160	410,020	350,986	374,349	251,250	187,808
Common equity ratio - Booked basis	37.60%	40.39%	49.66%	45.44%	46.09%	48.26%
Total Debt to Capital– Booked basis	60.12%	57.30%	47.66%	51.27%	49.36%	46.98%
Common equity ratio – With OBS	32.99%	37.35%	45.94%	41.09%	38.71%	41.99%
Total Debt to Capital – With OBS	65.01%	60.51%	51.58%	55.94%	57.46%	53.86%

Sources:
(1) PSCW Annual Reports – Financial Basis
(2) Includes $11,447,226, $8,343,390, and $4,865,215 for 2001, 2000, and 1999, respectively, booked as Advances from Associated companies. These amounts are associated with pensions for former WP&L employees working for Alliant Energy Corporate Services, Inc.
(3) Data from WP&L and Form 10-K to the Securities and Exchange Commission
(4) 1996 and 1997 reflect WPLH information
(5) Form 10-K to the Securities and Exchange Commission

[16] On August 30, 2001, AEC filed a petition with the PSCW for a letter of certification to the Securities and Exchange Commission (SEC) regarding its filing with the SEC for authority to invest up to $1.75 billion in foreign utility companies and exempt wholesale generators.

Table 5 contains additional financial statistics. The decreased earnings for 1998 were primarily due to merger-related expenses, higher purchased-power and transmission costs, higher depreciation and amortization expenses, decreased retail natural gas sales largely due to milder weather, higher injuries and damages expenses, higher interest expense and a higher effective tax rate.

Table 5
Selected Financial Statistics

	1996-2001					
	2001	2000	1999	1998	1997	1996
WP&L						
Pretax interest coverage (1)	3.64	3.56	3.84	2.65	4.47	5.33
Earned return on equity-regulatory (2)	9.33%	9.66%	10.66%	4.94%	10.75%	12.63%
Earned return on equity-financial (3)	9.74%	10.09%	11.19%	5.30%	11.32%	13.30%
U.S. Treasury bond yields-30 year (4)	5.49%	5.94%	5.87%	5.58%	6.61%	6.71%
	AEC/WPLH					
	2001	2000	1999	1998	1997	1996
AEC/WPLH (5)						
Pretax interest coverage (1)	2.32	4.61	3.38	2.25	3.19	3.82
Earned return on equity (6)	Not Reported	19.0%	10.5%	6.0%	10.1%	11.9%

Sources:
(1) Calculated from Form 10-K to the Securities and Exchange Commission
(2) Form PSC AF 6
(3) Form PSC AF 5
(4) Federal Reserve Statistical Release Website
(5) 1996 and 1997 data for WPLH and 1998-2001 data for AEC
(6) As reported in the Form 10-K to the Securities and Exchange Commission

Utility rates

Since the formation of Alliant in March 1998, no general rate increase has been ordered for WP&L. This is in keeping with the requirement for WP&L to "freeze" rates for four years upon approval of their merger, except for fuel changes and uncontrollable increases in excess of $4.5 million. During the freeze, a rate surcharge for Year 2000 computer expenditures was granted for $1.2 million for the natural gas utility and $5 million for the electric utility. Electric customers also had four emergency fuel increases and one performance based ratemaking decrease for a net increase of approximately $76 million. Currently, there is a general rate increase pending for WP&L.

Reliability of service

In its order approving the initial formation of WPLH in docket 9403-YO-100, the Commission stated that:

> It is necessary for WP&L, as for any utility, to maintain its investment in utility operations in order to remain a strong, ongoing utility. This is a requirement of its

franchise as a regulated monopoly. These utility investments can include, but need not be limited to, new construction of utility plant, utility system maintenance and upgrading, electric line loss reduction, conservation and other environmental considerations such as SO_2/NOx reduction.

In evaluating a utility's commitment to reliability of service, the Commission looks at numerous areas including the volume of service complaints, levels and effectiveness of maintenance, construction and other costs expended to upgrade the system, and the level of activity in areas such as least cost planning and transmission planning. The following are comments related to the Commission's review of these areas:

1. Complaints

Complaints received by the Commission related to WP&L or to the Alliant holding company system have been relatively steady from 1998-2000 with a sharp increase in billing and credit complaints in 2001 as shown in Table 6.

Table 6[17]

Year	Number of Billing and Credit Complaints	Number of Service Complaints
1998	344	108
1999	295	73
2000	366	56
2001	656	80

In 1999, there was a 14 percent decrease in the number of billing and credit complaints with the largest drop attributed to deferred payment agreements and disputed amount of use complaints. In 2000, there was a 24 percent increase in billing and credit complaints with 90 complaints attributed to deferred payment agreements.

In 2001, the increase of 79 percent in billing and credit complaints includes 234 complaints for billing procedures, 95 complaints for accuracy of billing, and 39 complaints for increases to the cost of natural gas. During December 2000, WP&L did not read some of its meters due to heavy snow levels. December bills were based on estimates from the prior year, which was warmer and resulted in under-billing. In January 2001, the meters were read and many customers received large bills due in part to the under-billing in December. In addition, there was a substantial increase in the cost of natural gas between December and January. These two events required WP&L to make numerous adjustments to correct customer bills to reflect actual December and January usage.

The service related complaints were minimal for the entire 1998 through 2001 period and have decreased by 26 percent from 1998 to 2001.

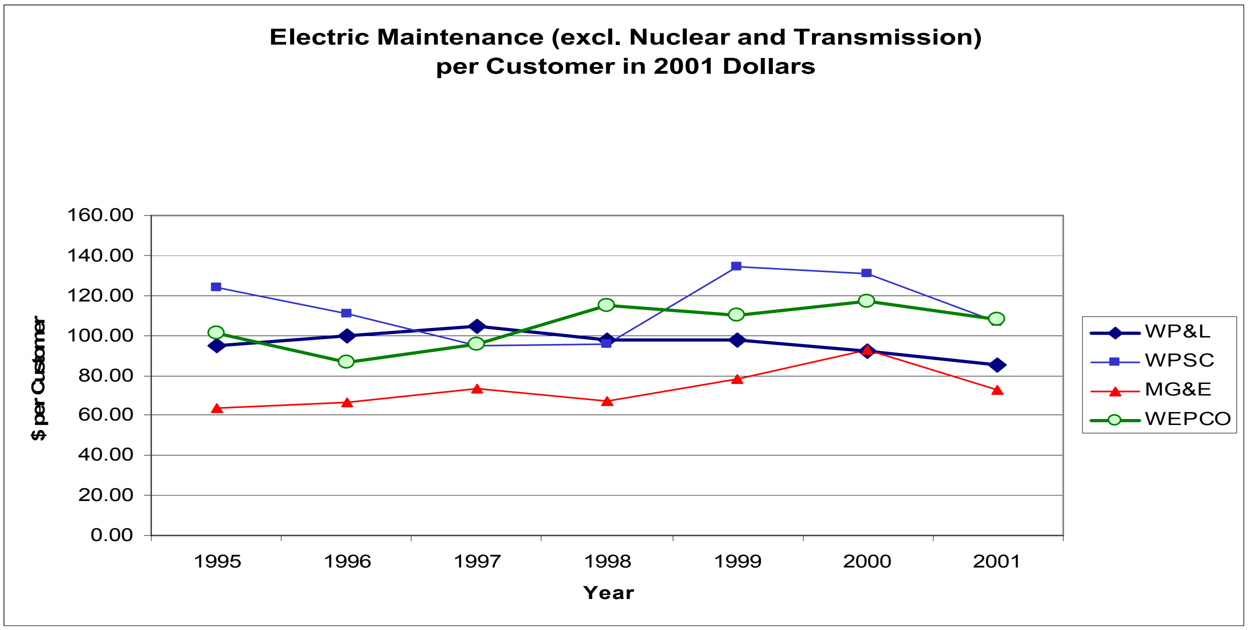
[17] This table includes the primary complaint of each contact plus any secondary complaints, i.e. there are more complaints than the number of people who filed complaints. A report containing only the primary complaints is included on the PSCW website.

2. Maintenance and Construction Activity

Total electric maintenance expense per customer, restated in 2001 dollars[18] and excluding nuclear and transmission maintenance,[19] was $104.56 in 1997 and decreased to $85.24 per customer in 2001 for WP&L as shown in Table 7. Electric maintenance expenses per customer increased for Wisconsin Electric Power Company (WEPCO) and Wisconsin Public Service Corporation (WPSC), and decreased slightly for Madison Gas & Electric (MGE) for the same period.

Total gas maintenance costs per customer, as shown in Table 8, increased slightly from $24.60 in 1997 to $25.70 in 2001. MGE's costs were up slightly, WPSC's costs were up steady for the 1997 through 2000 period with a sharp increase in 2001, and WEPCO's costs were down slightly.

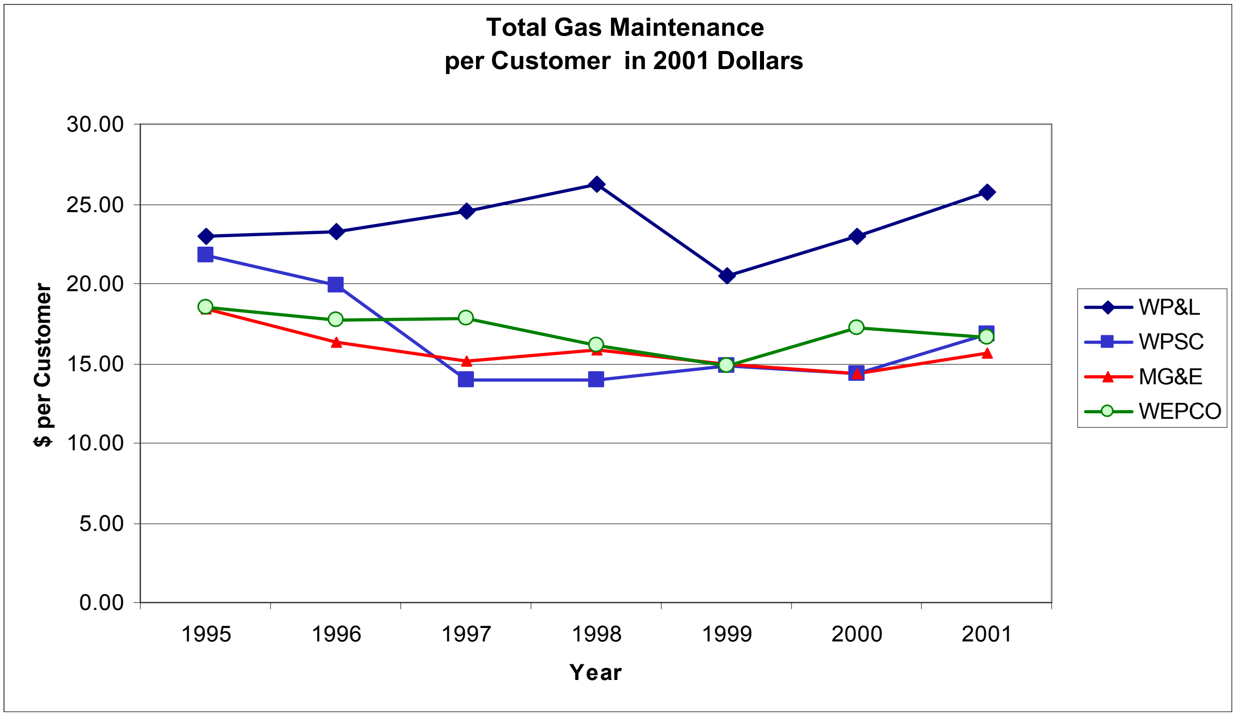
Table 7



[18] In order to recognize the impacts of inflation on utility costs and make comparisons more meaningful, Commission staff adjusted the reported maintenance and construction costs for each utility to restate the figures in 2001 dollars using the Handy Whitman Index.

[19] Since nuclear maintenance costs are controllable by WPSC as the operating partner, and transmission costs are controllable by the American Transmission Company LLC as of January 1, 2001, these costs were excluded for purposes of this comparison.

Table 8



Completed construction expenditures for WP&L (stated in 2001 dollars) averaged approximately $141 million for 2000-2001 which compares to an average of approximately $125 million for 1997 through 1999. Expenditures reached a high point in 2000 of $142 million as restated in 2001 dollars.

In order to reduce future energy demand and the need for new expensive power plants, WP&L provides Commission-approved energy efficiency services to its customers. Prior to the formation of the holding company, WP&L had conservation expenditures of less than $6 million per year. In the first four years after formation of the holding company, 1988 to 1991, WP&L spent over $73 million for energy efficiency programs. In the last nine years, WP&L spent over $125 million on Commission-approved energy efficiency programs, with expenditures increasing in each of the last three years.

3. Planning activity

In 1975 the Wisconsin Legislature created Wis. Stat. § 196.491 that provided an "advance plan" process to inform the Commission and the general public of the electric utilities' plans to meet their customers' energy needs. The Commission's advance plan process required utilities to file generation, transmission, and demand-side management plans every two years for Commission approval. 1997 Wisconsin Act 204 changed the statutes, replacing the advance plan process with a Strategic Energy Assessment (SEA). Investor-owned utilities still provide data every two years, but the Commission prepares the SEA. WP&L filed its information for the first SEA in February 2000.

At the present time, it does not appear that the decline in electric maintenance costs per customer has had a detrimental effect on quality of service. As noted earlier, service-related complaints have been minimal and have declined from 1998 to 2001 by approximately one-fourth. One possible concern may be that the decline in maintenance expenditures by WP&L when other major electric utilities in the state are increasing expenditures on maintenance may cause problems in the future. Part of this decline could be related to WP&L being under a rate freeze.

Since service-related complaints have not been a major issue for WP&L, it appears that the existence of a holding company structure has not harmed the quality of service.

Business of Nonutility Affiliates

The legislature found in Section 1(5) of the Wisconsin Act 79 that:

> The public interest and the interest of investors and consumers can be benefited if public utility holding companies, in the service territories of their public utility affiliates or in this state:
>
> (a) Conduct substantial business activities.
> (b) Attract new businesses.
> (c) Expand existing businesses.
> (d) Provide investment capital for new business ventures.
> (e) Otherwise directly or indirectly promote employment and commerce.

Wis. Stat. § 196.795(7)(a) provides that as part of the Commission's investigation of the impact of the holding company, a determination should be made whether each nonutility affiliate does, or can reasonably be expected to do, one of the following:

1. Substantially retain, substantially attract or substantially promote business activity or employment or provide capital to businesses being formed or operating within the wholesale or retail service territory, within or outside this state, of any public utility affiliate.
2. Increase or promote energy conservation or develop, produce or sell reusable energy products or equipment.
3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.
4. Develop or operate commercial or industrial parks in the wholesale or retail service territory of any public utility affiliate.

General information provided by Alliant is shown in appendices B, C, and D. Appendix B shows the major subsidiaries of Alliant as of December 2001. The major subsidiaries are WP&L, Interstate Power and Light Company (IPL),[20] Alliant Energy Resources, Inc. (previously known as Alliant Industries Inc.) and Alliant Energy Corporate Services, Inc. Appendix B is a

[20] IPC merged into IES in 2001. The name was then changed to Interstate Power and Light Company.

list of Alliant's nonutility affiliates as of December 2001, and the subsection of Wis. Stat. § 196.795(7) that applies to each affiliate. A list of Assets and Employees in total and located in Wisconsin for the major affiliates is included as Appendix C.

Proposed Legislation

As discussed previously, Wis. Stat. § 196.795 allows public utility holding companies to diversify into nonutility investments, limited by an asset cap provision, provided such investments meet one of four criteria under Wis. Stat. § 196.795(7)(a). Act 9 modified the asset cap limitation on nonutility investments of holding company systems, pursuant to Wis. Stat. § 196.795, to allow "eligible assets" to be excluded from the calculation of nonutility assets as a percentage of utility assets. Act 9 did not, however, modify sections 1 through 4 of Wis. Stat. § 196.795(7)(a), defining appropriate nonutility investments. Therefore, an ambiguity exists between what is allowable under the definition of appropriate nonutility investments and the types of investments that qualify for inclusion under the category of "eligible assets." Not all "eligible assets" will meet at least one of the four criteria of Wis. Stat. § 196.795(7). For instance, investments in assets that process waste material, or provide telecommunication service (as defined in s. 196.01 (9m)) are considered "eligible assets" but do not meet the criteria in Wis. Stat. § 196.795(7)(a).

If the nonutility investments of a public utility holding company do not, or cannot, reasonably be expected to meet one of the four criteria under Wis. Stat. § 196.795(7)(a), the holding company becomes subject to Wis. Stats. §§ 201.01(2) and 201.03(1) and the holding company is no longer exempt from the definition of a "public service corporation." Therefore, by reference, Wis. Stats. § 201.01(2) is specifically tied to the criteria in Wis. Stat. § 196.795(7)(a). Since Act 9 did not change or eliminate this reference, investments in "eligible assets" that do not meet one of the four criteria in Wis. Stat. § 196.795(7)(a) have the potential of subjecting the holding company to security regulation by the Commission. As a result, the holding company may not be able to issue securities without Commission approval.

It appears that the only successful way to address the ambiguities is to pursue statutory change. An addition of "eligible assets" as the fifth criteria in Wis. Stat. § 196.795(7)(a), should solve the basic problem.

Public Service Commission of Wisconsin

Audit Report on Alliant Energy Corporation for 2001

Audit Findings

Compliance with Wis. Stat. § 196.795(7)(a)

The list of nonutility affiliates provided by Alliant, included as Appendix B, includes many utility ventures located in foreign countries, and several RMT companies which are located outside of the Alliant service territory. According to Alliant, these comply with the above statute by being functionally related to the provision of utility service or to the development or acquisition of energy resources.

There is no true definition of the term "functionally related" within the Wisconsin Statutes, legislative history, or in state case law. The United States Supreme Court looked at the term "functionally related" in *Securities Industry Association v. Board of Governors of the Federal Reserve System,* 468 US 207, 82 L. Ed. 2d 158, 104 S.Ct 3008 (1984). The court dealt with the issue of whether the Board had the power under the Bank Holding Company Act to determine if a bank holding company could acquire a non-banking affiliate engaged principally in the business of a retail securities brokerage and was "closely related" to banking. The Court noted the difference between "closely related" and "functionally related."[21] Congress was found to have rejected the "functionally related" test and the Court stated it thought the "closely related" test broadened the Board's powers. Thus, it could be inferred that the "functionally related" test is more restrictive.

On this basis, it appears that the RMT companies which provide environmental engineering and consulting, Alliant Energy Transportation, Inc. which provides storage facilities and railcar inspection services, and investments in utilities in foreign countries, although related within a broad sense, may not be "functionally related" as required by this statute. These companies would likely qualify as "eligible assets."

Village Lakeshares LP and Village Lakeshares Inc. are listed as qualifying under item four which relates to development or operation of commercial or industrial parks. Based on information previously provided to the Commission, these companies own a hotel and time share units located in Iowa. It appears these companies do not qualify under Wis. Stat. § 196.795(7)(a), nor would they be considered to be "eligible assets."

Two telecommunications affiliates are listed as being exempt under Wis. Stat. § 196.795(8). This section exempts telecommunications utilities from regulation under the holding company law. This does not relieve the utility and Alliant from the requirement that investments of theirs can reasonably be expected to do at least one of the items designated in Wis. Stat. § 196.795(7)(a). Telecommunications companies would be eligible assets, but do not qualify under Wis. Stat. § 196.795(7)(a)(3), but could possibly qualify under Wis. Stat. §

[21] See ID. At 215 n. 12.

196.795(7)(a)(1) if they operate within the wholesale or retail service territory of the public utility affiliate.

Required Holding Company Filings

The merger order requires Alliant to submit an annual holding company filing that includes such items as the annual filings with the SEC, a copy of the annual report to the stockholders, calculation of the asset cap on nonutility investments, and any audited financial statements or filings of nonutility affiliates. Since the materials filed with the SEC comprise a large portion of the annual holding company filing with the Commission, Alliant and WP&L have requested and received approval to submit this filing on May 1 each year rather than with their annual report to the PSCW on April 1. The filing for 2001, will be due on May 1, 2002.

WP&L is required to provide an annual update to the Commission on the status of the Security Blanket program[22] under the order in docket 6680-EI-103. This update was filed as required. Since there have been no complaints about this program for the past two or more years, the report may no longer be necessary. The utility may want to request that the Commission modify its order to eliminate this filing requirement.

Wis. Stat. § 196.795(6) requires that the holding company notify the Commission no more than 10 business days after the formation, organization, or acquisition of a nonutility affiliate and provide the Commission with information specified in subsections (a) to (c). As a general rule Alliant provides notifications of new investments on a quarterly basis. Individual notices were provided for many companies, but the transactions reported in 2000-2001 do not include the date formed, organized or acquired for most of the reported transactions. It would be possible to obtain the date formed for many of these companies from the quarterly filing, but that audit step was not performed.

Alliant provided the Commission with a list of entities within the Alliant system which is included as Appendix B. This list was compared to a list of companies developed based on Alliant's individual or quarterly notifications of new nonutility affiliates. There are 55 companies on Alliant's list which are not on the list based on new affiliate notifications. Alliant was asked to explain why it failed to notify the Commission of these entities pursuant to Wis. Stat. § 196.795(6), but their response is not expected before this report is completed.

Under Wis. Stat. § 196.795(6)(d), information on assets and employees within and outside of Wisconsin is required to be filed annually by March 31. Alliant filed this information on time for both 2000 and 2001 calendar years. A copy of the report for 2001 is included as Appendix C.

Affiliated Interest Review

Commission staff reviewed the operation of the utility's accounts receivable sales program for 2001. Based on our findings, it appears that WP&L is in compliance with the Commission's order in docket 6680-AU-110; however, the utility is not in compliance with the associated sales

[22] This is a nonutility program of WP&L's which provides furnace and air conditioning maintenance and repair agreements.

agreement. This agreement provides for WP&L to sell all of their eligible receivables to WP&L SPE. On average only about 73 percent were sold in 2001. The sales agreement should be amended to allow the utility to sell all or part of their eligible receivables, at their discretion, or WP&L should comply with the agreement and sell 100 percent as currently required.

WP&L Rate Case in Docket 6680-UR-111

For the pending WP&L rate case in docket 6680-UR-111, Commission staff proposed an adjustment to reduce the level of WP&L's requested revenue for outside services by $200,000. As noted in the attached SEC report,[23] SEC staff disagreed with the allocation of a number of invoices that were reviewed. Commission staff therefore adjusted outside services to recognize that the historic allocations to the utility were overstated, which would result in the trended cost for outside services being overstated.

An adjustment was also proposed to reduce the revenue requirement for advertising by $800,000 to allow only safety, conservation or advertising required by law. Goodwill, name recognition, and branding advertisements were not included in costs to be recovered from ratepayers.

The adjustments proposed by Commission staff for outside services and advertising are not being contested by WP&L.

Testimony was also filed in the case that relates to the allocation of officers' time to the utility and nonutility affiliates. The following is an excerpt from the testimony of Commission staff witness, Mr. Thomas Ferris.

> In its most recent audit of Alliant Energy, the SEC questioned the level of allocation of officer salaries to WP&L and the other utilities. Commission staff participated in this audit with the SEC. For most officers, the percent of total compensation allocated to WP&L was much lower in 1998 versus the allocation in 2002. In its response to the SEC, WP&L maintained that the lower allocation percentages in 1998 were due to merger activity going on at that time. While this may be true, Commission staff notes that Alliant Energy has increased its activity in investing in foreign utilities and other non-utility activities. Alliant Energy has received approval from the Commission to invest 100 percent of WP&L's retained earnings in foreign utility companies and electric wholesale generators. In addition, Alliant Energy has also submitted a request to increase this percentage to over 200 percent. This non-utility activity would tend to increase the amount of time officers spend on non-utility activities. Finally, Mr. Errol Davis, Chairman and Chief Executive Officer of Alliant Energy, is expected to spend over 85 percent of his time on utility activities. Since WP&L has its own President, it could be argued that the time Mr. Davis spends on utility activities is actually on behalf of the Alliant Energy shareholders to protect their investment in WP&L and the other utilities.

Mr. Ferris goes on to say that:

[23] Appendix E, page 13, Item 19.

> Based on Commission staff's analysis, using the 1998 allocation percentages would reduce the amounts allocated to WP&L by approximately $300,000. Of this amount, almost $200,000 relates to Mr. Davis' time. Some percentage of this amount may be capitalized.

The actual amount of any adjustment for officers' salaries will be determined when the Commission makes its decision in this case (anticipated in June 2002).

Allocation of Officers' Time

Although an adjustment was proposed in the rate case in docket 6680-UR-111 as discussed above, a detailed review of officers' time was not completed during the rate case audit. Additional findings and recommendations since the completion of the rate case audit are detailed below.

Service Company Agreement Requirements

Section 2.1 of the Service Agreement between AES and WP&L indicates that WP&L shall pay to the service company "all costs which reasonably can be identified and related to particular services performed by the Service Company for or on behalf of such Client Company."

Section 2.2 indicates that "it is the intent of this Agreement that charges for services shall be distributed among the Client Companies, to the extent possible, based upon direct assignment. The amounts remaining after direct assignment shall be allocated among the Client Companies (and other affiliate companies of Alliant Energy Corporation….using the method identified in Appendix A)."

Appendix A states that to the extent practicable, time records of hours worked by Service Company employees will be kept by activity, project, program or work order. Where identifiable to a particular activity, project, program or work order, such costs will be directly assigned. Costs that are not directly assigned are then to be allocated based on cost-causal relationship. Costs for services of a general nature, remaining after the cost-causal allocation, are then to be distributed using the ratios described in Appendix A.

Review of Timesheets

Commission staff reviewed all of the timesheets for 2001 for the following officers of Alliant: the Chairman, President and CEO; the Executive Vice President and General Counsel; and the Executive Vice President and CFO. The group calendars for these individuals were also reviewed, but were not available for all months for all individuals.

Commission staff found that only 5 percent of their combined productive time was charged to special projects or programs, 11 percent was allocated to specific entities, presumably based on a cost-causal relationship, and the majority of their productive time (84 percent) was charged to Code 10. Costs charged to Code 10 were then allocated using the General Ratio[24] and resulted in

[24] The General Ratio is discussed in more detail in the following sections.

only 5 percent being charged to the parent company and nonutility affiliates, 39.3 percent to WP&L, 38.1 percent to IES and 17.6 percent to IPC for 2001. In other words, 95 percent of the costs in the Code 10 category were allocated to the utilities.

A review of cost allocations for other Alliant officers[25] was also done on a less detailed level. In summary, these officers direct charged projects or activities for 2 percent of their productive time, an additional 52.9 percent was allocated to specific entities based on cost-causation, leaving 45.1 percent charged to Code 10. A specific review was not done to determine how much of the time charged to Code 10 by these officers was then allocated using the General Ratio, but based on their position descriptions it would be likely that the majority of the Code 10 costs for these officers would also be allocated using the General Ratio.

In response to the SEC audit, meetings were held in June 2001, with business unit financial managers, and in August 2001, with the senior management team, and follow up meetings were held with the Office Administrators Group. These meetings were to explain the results of the SEC audit and emphasized the importance of proper time charging, direct charging, and assignment of client codes.[26] A noticeable change in cost allocations for the officers reviewed took place in mid 2001, presumably as a result of these informational meetings.

Comparing the fourth quarter of 2001 to the first quarter of the year, the allocations of the productive time for the individual who is Chairman, President and CEO charged to AEC and the nonutility affiliated increased from 19 to 30 percent. For the individual who is Executive Vice President and CFO there was an increase from 6 to 27 percent. Other officer's that showed a significant increase in time charged to nonutility affiliates included the Assistant Corporate Secretary with an increase from 5 to 77 percent; and the Corporate Controller and Chief Accounting Officer with an increase from 16 to 40 percent.

In addition to the finding that very little time is being direct charged or allocated on at cost-causal basis as specified in the affiliated interest agreement, the Commission staff found examples of nonutility costs that were incorrectly charged, including among others, one instance when 58 hours[27] were charged to Code 10 during a week when the officer was out of the country dealing with a non-regulated foreign investment, and another instance when a fundraiser for an Iowa Senator was charged to Code 10. There are also items on the corporate calendars for such things as United Way, AE Foundation, BP Petroleum, EEI, and various conferences that are also classified as Code 10 which are questionable. The treatment of time while in travel status was another questionable item.

Commission staff interviewed the two individuals responsible for the completion of officer timesheets to determine how total productive hours were determined; what the "u" or unbilled code meant; whether they had received instructions or attended meetings about the need to direct

[25] Officers who charged all or most of their time to either the nonutility affiliates, or to the utilities and seldom used cost allocators were excluded from the review.

[26] See SEC report, Appendix E, page 3.

[27] Approximately $12,500 before payroll and overhead loadings.

charge time whenever possible; what changes these meetings had on how they prepared timesheets; if there was a company policy for charging time for social functions, dinners, picnics etc., and how travel time in route to meetings and conferences should be handled.

Based on our interviews, neither of the officers provides much, if any, specific guidance as to how to charge time to the various projects or entities. Both individuals we interviewed are very knowledgeable about the activities performed by their respective officers and that knowledge is used in determining such items as the total hours to charge on a day when there is a board meeting, how to charge time for a conference that is attended on a regular basis without instruction from the officer, and how to charge business dinners based on the name of the business guest. Both individuals were aware of the need to do more accurate and direct time charging, based on information circulated through the company or through presentations at staff meetings.

There does not appear to be a policy on how to handle travel while in route to conferences or business meetings. Neither of the individuals interviewed knew how the costs charged to Code 10 would be allocated, only that all entities would be charged. When asked if a 5 percent allocation to nonutility entities would be reasonable, one secretary indicated that this did not sound right based on her knowledge and experience. There was also a perception that hours charged to "u" or unbilled did not need to be as carefully considered since this was unbilled time (greater that 80 hours per pay period) and would not change the amount the officer was paid.[28]

Cost Allocation - General Ratio

Time that is charged to all entities (Code 10) can be allocated based on many different Ratios as specified in Appendix A of the Service Agreements between AEC, the Service Company, WP&L and other affiliated utility and nonutility affiliates. The General Ratio is used for all of the following functions: Accounting, Public Affairs, Legal, Finance, Internal Audit, Planning, and Executive.

The General Ratio is based on the ratio of costs directly charged or allocated to each entity to the sum of all Service Company expenses directly assigned or allocated using a cost-causal relationship[29] in the prior twelve consecutive calendar months. For 2001, the general Ratio results in about 5 percent of the costs being allocated to the parent company and the various nonutility affiliates, and 95 percent to the utilities.

Based on a review of the results of using the general ratio for the top three executives at WP&L it appears that both the calculation of this ratio and the way it is being applied needs to be reviewed. It is unrealistic to believe that for 2001, the individual who is Chairman, President and CEO of Alliant only spends 24 percent of his productive time on nonutility companies and

[28] The "u" code hours do have costs allocated to them in the same manner as the hours under 80 and should therefore be given the same consideration as other hours.

[29] Excluding fuel, gas purchased power and the cost of goods sold

functions, especially when the nonutility affiliates have increased to over 330 in number and represented over 69 percent[30] of total utility assets on December 31, 2000.

During the course of Commission staff's review, the allocation of Service Company assets between the utilities and nonutility affiliates was reviewed. For those assets that were not allocated to the utilities on a cost-causal basis, it appears that the general Ratio was applied and 5 percent of the total assets were allocated to the nonutility affiliates. These assets appear to be functionally related to accounting, finance, information systems, and planning among others. Most of these functions could call for use of the general ratio for any costs remaining after direct allocation and allocation on a cost-causal basis. However, the information systems function does not use the general ratio. The nature of the assets being allocated should be reviewed to determine if the appropriate ratios are being used.

Summary and Recommendations

Dividend Restrictions

As noted on page 8 of this report, WP&L was not in compliance with the dividend restriction in place for 2001. Commission staff recommends that this lack of compliance with the dividend restriction be considered in future Commission decisions and actions.

Timing of Filings

Commission staff recommends that Alliant review the statutory filing requirement and establish policies or procedures to ensure that all required notifications of new nonutility affiliates be submitted within 10 business days as required by Wis. Stat. § 196.795(6). These notifications should include the date the affiliate is formed, organized or acquired in addition to the information required by subsections (a) and (b).

Affiliated Interest – Docket 6680-AU-110

Commission staff recommends that WP&L either comply with the requirement to sell all of its accounts receivable to WP&L SPE, or change the sales agreement associated with the affiliated interest approved in docket 6680-AU-110 to allow the sale of less than 100 percent.

Allocations of Officers' Time and General Ratio

As required by the Service Agreement, more officer time needs to be charged on a direct or cost-causal basis. Ideally, the costs which are being charged using a General Ratio should be limited, and should not exceed 20-25 percent of the total productive time. Some improvement was made in direct charging nonutility projects and entities by the end of 2001, but more improvement is needed.

[30] Before adjustment for "eligible assets."

If the costs subject to the General Ratio cannot be reduced significantly, it may be necessary to develop a new ratio which more realistically spreads costs to the parent company and the nonutility affiliates. Another way to address this would be to limit charges to the utilities to only those costs that can be specifically identified.

An argument can also be made, at least for Mr. Davis, that the time spent on utility activities is actually on behalf of the Alliant Energy shareholders to protect their investment in WP&L and that even if costs are charged to WP&L they should not be charged to WP&L ratepayers.

The manner in which the General Ratio is calculated is producing unrealistic results as noted above. Commission staff recommends that the method used to calculate the ratio be reviewed to determine if separate ratios should be developed for payroll and for invoices, or if a general ratio based on a combination of assets, revenues and number of employees such as the one used by WPS Resources, Inc. would provide more reasonable results.[31]

Commission staff recommends:

1. That Alliant and WP&L limit the use of the General Ratio as discussed above.

2. That a policy be developed which requires travel time be allocated on same basis as the conference, meeting, etc. that is being attended.

3. That the calculation and use of the General Ratio, the allocation of officer's time to WP&L, and the allocation of Service Company assets to WP&L, be reviewed in determining the appropriate costs to be included in the revenue requirement in the next WP&L rate case for the 2003 test year.

G:\Holding Company\AEC 2001 Report To Legislature To Commission 6-20-02.Doc

[31] For 2001 WPS Resources's general Ratio resulted in about 41 percent being allocated to the nonutility affiliates.